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CHARLES ELMORE CROPLEY

IN THE

# Supreme Court of the United States

**October Term, 1935**

No. 17

T. A. MORRISSEY and JAMES M. O'BRIEN, Trustees of an Express Trust, known as Western Avenue Golf Club, *Petitioners,*

against

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

**On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit**

## MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE,* AND BRIEF


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## MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

*May it please the Court:*

The undersigned, Claude A. Hope, respectfully moves the Court for leave to file the accompanying brief, as *amicus curiae*, and in support of this motion, shows unto the Court as follows:

The essential question to be determined by this Court is the construction of the word "association" when used in a tax statute.

The undersigned is not employed as counsel in the above-entitled case, but is counsel for the trustees of several investment trusts which the Bureau of Internal Revenue has heretofore held to be strict trusts, and not associations. The decision in this case as to the correct meaning of the word "association" will largely determine whether these trusts will continue to be held taxable as strict trusts and not as associations. Many thousands of investors are beneficiaries of these trusts which represent an investment of many millions of dollars.

The purpose of this brief is to present to this Court the view that the word "association" when used in a statute imposing taxes or other liabilities is uniformly held to include only organizations which do business for profit under the usual forms and procedure of corporations.

The attorneys for the respondent and the attorneys for petitioners have consented in writing to the filing of this brief by the undersigned.

The undersigned therefore requests that this Court permit him to file the following brief as *amicus curiae* in the above-entitled matter.

CLAUDE A. HOPE,
20 Exchange Place,
New York, New York.
*Amicus Curiae.*

JOHN ROSS DELAFIELD,
*Of Counsel.*

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**On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit**

## BRIEF OF *AMICUS CURIAE*

### Preliminary Statement

The above entitled case presents to the Court the necessity of determining whether the organization involved, the Western Avenue Golf Club, is an "association" or a "trust" under the Revenue Acts of 1924 and 1926 and the regulations issued thereunder. This general question is not new. It has been before the lower Courts and the Bureau of Internal Revenue a great many times and in a great many forms.

The Revenue Acts have always provided that "associations" should be treated as corporations. No subsequent Act has changed the original wording of the Revenue Act of 1918 that "The term 'corporation' includes associations, joint stock companies, and insurance companies" (Sec. 1, c. 18, 40 Stat. 1057). The sentence as quoted appears unchanged in the current Revenue Act.

On August 31, 1925, the Treasury Department adopted a regulation, discussed elsewhere in this brief, establishing certain tests under which some organizations, admittedly common law trusts, were to be treated under the Revenue Act as "associations" and, therefore, were to be subjected to taxation as corporations. The regulation followed closely the prineiples laid down in a number of cases decided prior to its adoption, including the decision of this Court in *Hecht* v. *Malley*, 265 U. S. 144. A great many specific rulings were issued under it by the Commissioners of Internal Revenue. A large number of organizations were formed relying upon the regulation and the announced rulings as establishing the law applicable to the question,—at least until the Congress saw fit, by appropriate amendment of the law, to change it.

During recent months there has been a distinct tendency on the part of the Bureau to stray from these established tests. See, for example, Arts. 801-2 and 801-3 of Treasury Department Regulations 86 (the regulations under the Revenue Act of 1934) which are set forth in the Appendix hereto. Notwithstanding the fact that there has been no change in the statute, these regulations entirely disregard the fundamental test established by the Courts that a trust, in order to be taxable as an association, must be engaged in business for profit under the usual forms and procedure of corporations.

A great many trusts which for many years, in accordance with specific rulings previously obtained, have filed tax returns under the appropriate Revenue Acts as strict trusts and not as associations, are faced with the distinct possibility of a reversal of those rulings. It is believed that the decision in the case at bar will have a substantial if not controlling effect upon the determination of the ultimate taxable status of such organizations. The case before the Court, therefore, will undoubtedly have consequences of far greater importance than is indicated by the facts presented and the amount involved. Many thousands of persons and many millions of dollars in property will be affected. In the field of non-discretionary investment trusts alone, which trusts are formed under common law trust indentures, there is upwards of $100,000,000 involved affecting perhaps 100,000 or more persons. This brief is filed on behalf of trustees acting for several such trusts having approximately $54,360,000 in property and approximately 63,500 beneficiaries.

The trustees and beneficiaries of these trusts, who are not parties to the litigation before the Court, are primarily interested, not in the outcome of the instant case, but in the rules or tests which this Court may lay down in determining whether the trust before it is, for taxation purposes, a strict trust or an association, and particularly are they interested in the maintenance and continuation of the well established rule that the word "association" when used in a taxing statute includes only organizations which do business for profit under the usual forms and procedure of corporations.

## THE ARGUMENT

### I

**The word "association" when used in a statute imposing taxes or other liabilities is uniformly held to include only organizations which do business for profit under the usual forms and procedure of corporations.**

*In re The St. James's Club,* 13 English Law & Eq. 589 (1852), was an appeal from an order of the Vice-Chancellor whereby he ordered the above association to be dissolved and referred it to the Master to wind up the affairs of the club under the provisions of the Winding-up Acts, 11 & 12 Vict, c. 45 as amended by 12 & 13 Vict. c. 108. The appellant urged that the Winding-up Acts did not apply as the association was not established for profit. 12 & 13 Vict. c. 108 amended 11 & 12 Vict. c. 45 and provided

> "that notwithstanding anything in the said act contained importing a more limited application thereof, the same shall apply to all partnerships, associations, and companies * * * "

The Lord Chancellor (Lord St. Leonards) held that the club was not an association within the meaning of the Act, and said:

> "Now, although the word 'association' is here used, and though an 'association' may include bodies of persons who are neither partners nor members of a company, properly so called, yet it would be difficult to convince me that the word 'association,' occurring as it does between those two words, 'partnership' and 'company,' is to be treated generally—that is, to mean every association, without reference to the particular bodies with which the term is so closely associated. * * * An 'association' it is, but

> not an 'association' within the meaning of the statute, considering between what words we find the word introduced in the statute. When I look, therefore, at this latter statute, I find that every provision in it is inconsistent with the notion that the legislature intended to include clubs in the word 'association.' If it did so intend, how is it that we do not find the word 'club' in the act? Clubs are very well known to exist, and it is impossible to suppose that the word would not have found its way into the act, had the legislature intended to include them. And I think that the judges are bound not to extend unnecessarily the meaning of words thus ambiguous to institutions which are well known to exist to a very great extent, and might have been introduced by a word" (p. 594).

In *Hecht* v. *Malley*, 265 U. S. 144 (1924), this Court said at page 157:

> "We think that the word 'association,' as used in the Act, clearly includes 'Massachusetts Trusts' such as those herein involved, having quasi-corporate organizations under which they are engaged *in carrying on business enterprises.* What other form of 'associations,' if any, it includes, we need not, and do not, determine." (Italics ours.)

The Circuit Courts of Appeals for the First, Second, Third, Fifth, Seventh, and Ninth Circuits have held that a trust must be engaged in doing business for profit in order to constitute an association within the meaning of the Revenue Acts.

**First Circuit**

In *Lansdowne Realty Trust* v. *Commissioner*, 50 Fed. (2d) 56 (C. C. A., 1st Cir), the Court said at page 58:

> "We are also of the opinion that the trust was

not an association and taxable as a corporation on the ground that it was doing business as such.

* * * * *

By the terms of the lease the lessees were to keep the premises in repair, pay the insurance, and be responsible for all damages connected with the building. It is perfectly apparent that they were not doing business in any sense, during the years 1923 and 1924, and we are of the opinion that, during the years 1925 and 1926, *they were not conducting business* after the mode and manner of a corporation, but were doing nothing more than trustees ordinarily would be called upon to perform in the management of trust property." (Italics ours.)

In *Commissioner of Internal Revenue* v. *Kelley*, 74 Fed. (2d) 71 (C. C. A., 1st Cir.), the Court said at page 75:

"To constitute a trust an association, and taxable as a corporation, there must be a body of persons associated together who are (1) actually carrying on business for profit, and (2) under the usual forms and procedure of corporations. Both conditions must be present."

In *Coleman-Gilbert Associates* v. *Commissioner*, 76 Fed. (2d) 191 (C. C. A., 1st Cir.), the Court said at page 194:

"We think, however, it is generally agreed that, in order for a trust to be taxed as a corporation, the trustees must not only be carrying on a business enterprise for profit, but must be doing it in much the same manner and form as directors of a corporation."

**Second Circuit**

In *Allen* v. *Commissioner*, 49 Fed. (2d) 716 (C. C. A., 2nd Cir.), certiorari denied 284 U. S. 655, the Court said at page 717:

"This was not a trust like those before the Court in *Hecht* v. *Malley*, 265 U. S. 144, 44 S. Ct. 462, 68 L. Ed. 949, where the trustee *was conducting a business.* The only purpose was to hold the assets as security for a season, and then to distribute them." (Italics ours.)

**Third Circuit**

In *Little Four Oil & Gas Co.* v. *Lewellyn*, 35 Fed. (2d) 149 (C. C. A., 3rd Cir.), certiorari denied 280 U. S. 613, the Court said at page 150:

"The theory that the distinction between trusts of these classes and their consequent liability for taxes is based on the powers exercised by the shareholders—great or little—is no longer seriously regarded. *The real test is whether the shareholders or trustees, or both combined, carry on business for profit*, and, if they do, they constitute a business trust—in legal effect an association or a joint-stock company—with liability for taxes." (Italics ours.)

In *Smith* v. *Commissioner*, 69 Fed. (2d) 911 (C. C. A., 3rd Cir.), certiorari denied 293 U. S. 561, the court said at page 912:

"The test laid down by this court in *Little Four Oil & Gas Co.* v. *Lewellyn* (C. C. A.) 35 F. (2d) 149, is that, *if the trust is a business concern*, and if the shareholders or trustees, or both combined, *are operating it in active business for profit*, the trust is in effect an association taxable as a 'corporation.'" (Italics ours.)

**Fifth Circuit**

In *Lucas* v. *Extension Oil Co.*, 47 Fed. (2d) 65 (C. C. A., 5th Cir.) the court said at page 67:

"Believing that it would be a wresting of judg-

ment to hold under the facts of this case that respondent was within the statute invoked *doing a corporate business,* and subject to be taxed as a corporation, the petition for review of the judgment of the Board of Tax Appeals is denied, and the judgment is affirmed." (Italics ours.)

**Seventh Circuit**

In *Reinecke* v. *Kaempfer,* 72 Fed. (2d) 469, (C. C. A., 7th Cir.) the court said at page 470:

> "It is plain that from its inception the business was carried on for profit. * * *
>
> We are satisfied that the similitude referred to is not in those essentials which distinctly stamp the entity as a corporation, but rather in the business carried on and the manner of its transaction. This entity carried on its business in substantially the same way that a corporation would have carried it on. It regularly bought and sold merchandise for the purpose of realizing profit thereon; * * *"

**Ninth Circuit**

In *Trust No. 5833, Security-First Nat'l. Bank* v. *Welch,* 54 Fed. (2d) 323 (C. C. A., 9th Cir.) certiorari denied 286 U. S. 544, the court said at page 327:

> "If we accept, as we think we should, the interpretation placed upon the word 'association' by the Commissioner of Internal Revenue, inferentially approved and adopted by Congress in subsequent legislation, based upon the decision of the Supreme Court in *Hecht* v. *Malley, supra,* it follows that there are two criteria for determining whether or not an organization or combination of individuals is taxable as an association. The first test found in article 1312 is *the business test;* that is to say, the test

> as to whether or not the organization formed '*to do business* in an organized capacity' and for the distribution *of the profits* among the shareholders in proportion to the investment or shares." (Italics ours).

In *Willis* v. *Commissioner*, 58 Fed. (2d) 121 (C. C. A., 9th Cir.), the court said at page 122:

> "Simply stated, the question is, did the trustees manage and operate the property in their charge *as a business*, with the purpose to *accumulate a profit* by the use of it, or was their sole purpose, intended and pursued, to dispose of it as rapidly as possible, market conditions considered, and divide the proceeds among the beneficiaries? As a liquidating trust purely, the income would not be taxable; as a business venture, the income would be taxable." (Italics ours.)

In *Sloan* v. *Commissioner*, 63 Fed. (2d) 666 (C. C. A., 9th Cir.) the court said at page 669:

> "We think that petitioners are an association within the meaning of the law and regulations of the Treasury Department, and that they were engaged in business for profit during the taxable years in question."

In *Twin Bell Oil Syndicate* v. *Helvering*, 70 Fed. (2d) 402 (C. C. A., 9th Cir.); which was reversed on another issue in 293 U. S. 312, the court said at page 407:

> "There is ample additional authority for the proposition that the 'business' test is now paramount."

**Tenth Circuit**

At first glance it might appear that the Circuit Court of Appeals for the Tenth Circuit has rejected the business

test in its decision in *Commissioner* v. *Pryor & Lockhart Development Co.*, 70 Fed. (2d) 154, certiorari denied 293 U. S. 574, because its decision contains the following statement:

> "The fact that a group of persons associate themselves together for the purpose of engaging in business for profit does not necessarily mean that they must be taxed as an association. That is not the decisive consideration."

In that case certain persons interested in oil leases conveyed property to trustees to sell interests therein and develop leases. The trustees decided what wells should be drilled and sold the oil. No officers were elected and, except in one instance, no meetings of the beneficiaries were held. The beneficiaries exercised no control over the trustees. It was held that the trusts were not associations under the Revenue Acts of 1918, 1924, 1926 and 1928. It is therefore to be noted that the Circuit Court of Appeals for the Tenth Circuit did not reject the business test as a necessary test, but merely said that the business test was not the only test. In the case cited, the trust was plainly engaged in business, yet it was held not taxable as an association because its business was not conducted after the method and form of a corporation.

---

No case involving the question under consideration has been found in the Fourth, Sixth or Eighth Circuits, either in the Circuit Courts of Appeals or in the District Courts.

It is thus seen that there is no conflict between the various Circuit Courts of Appeals as to the necessity that a trust be engaged in business for profit in order to constitute an association, and that this test is one of the tests that are invariably applied.

The decisions of the Board of Tax Appeals are to the same effect.

In *Sturgeon & Hubbard* v. *Commissioner*, 25 B. T. A. 368, the Board said:

> "This Board has held that the significant tests to be applied in determining whether an alleged trust is a trust or an association taxable as a corporation, are whether (1) the beneficiaries of the alleged trust have voluntarily associated themselves together in the general form and mode of procedure of a corporation, and (2) are organized to, and in fact are, engaged in the active conduct of a business for profit, or (3) whether the trustees are merely holding the property and collecting the income therefrom and distributing to those beneficially interested."

In *Franklin Title & Trust Co.* v. *Commissioner*, 32 B. T. A. 266 (promulgated March 28, 1935), the Board said:

> "There is a more important circumstance which alone is fatal to the contention of the trust company—this trust was not organized for the purpose of carrying on a business and, during the taxable years, it did not carry on a business, as distinguished from the normal activities of a mere fiduciary. See, for importance of 'business' test, *Twin Bell Oil Syndicate* v. *Helvering*, 70 Fed. (2d) 402, affirming on this point, 26 B. T. A. 172; *Tyson* v. *Commissioner*, 68 Fed. (2d) 584; certiorari denied, 292 U. S. 657; *Montovia Oil Co.*, 28 B. T. A. 335."

A double tax upon the income of a trust, *viz.*, a tax, first, on the income of the trust as an entity, and a further tax upon the distributive shares of the beneficiaries, should, if applied, be imposed in clear and unmistakable language in the acts of Congress, and should not have as its

basis some mere resemblance in one way or another to a corporation. As Lord St. Leonards said *In re The St. James's Club, supra,* judges are bound not to extend unnecessarily the meaning of words as ambiguous as "association" to institutions which are well known to exist to a very great extent when such institutions could have been readily covered by appropriate language. And it is well established in this court that if there is doubt, the doubt should be resolved in favor of the taxpayer (*Crocker* v. *Malley,* 249 U. S. 223, at page 233; *Hecht* v. *Malley,* 265 U. S. 144, at page 160).

And yet, if in disposing of the case before it, this Court does not include in whatever tests it lays down, the requirement, among others, that business must be carried on for profit by a trust in order for it to be taxed as an association, the effect will be to throw many organizations not specifically mentioned in the Acts, though well known to Congress to exist, into classification as associations.

## II

**By re-enacting in the Revenue Acts of 1926, 1928, 1932 and 1934 the provisions of Sec. 2 (a) (2) of the Revenue Act of 1924 Congress has ratified and adopted the construction of the Treasury Department of the meaning of the word "association" as contained in Art. 1504 of Treasury Department Regulations 65 as amended Aug. 31, 1925.**

Sec. 2 (a) (2) of the Revenue Act of 1924 (c. 234, 43 Stat. 253) provides:

> "The term 'corporation' includes associations, joint stock companies, and insurance companies."

The same provision is contained in the Revenue Acts of 1926, 1928, 1932 and 1934. (Sec. 2, Revenue Act of 1926 (c. 27, 44 Stat. 9); Sec. 701, Revenue Act of 1928 (c. 852, 45 Stat. 791); Sec. 1111, Revenue Act of 1932 (c. 209, 47 Stat. 169); Sec. 801, Revenue Act of 1934 (c. 277, 48 Stat. 680). None of these statutes gave any definition of an association.

The regulations of the Treasury Department having to do with the distinction between a trust and an association have, from August 31st, 1925, down to the promulgation of the regulations under the Revenue Act of 1934, been based upon the decision in *Hecht* v. *Malley*, 265 U. S. 144. Art. 1504 of Treasury Regulations 65 as amended by T. D. 3748 (C. B. IV-2, page 7) on August 31st, 1925 (the regulations under the Revenue Act of 1924), is typical and is as follows:

> "Art. 1504. Association Distinguished from Trust. Where trustees merely hold property for the collection of the income and its distribution among

> the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by Section 219 and by Articles 341-347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of Section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute."

Since the promulgation of these regulations, Congress has re-enacted in the Revenue Acts of 1926, 1928, 1932 and 1934 the same statutory provision which was construed by the Treasury Department in the above quoted regulation. This is persuasive evidence of legislative approval of the regulation. There are also many cases which hold that such re-enactment confirmed and carried forward the policy evidenced by the earlier enactment as interpreted in the regulations promulgated under it.

In *Brewster* v. *Gage*, 280 U. S. 327, the Court said:

> "The substantial re-enactment in later Acts of the provision theretofore construed by the Department is persuasive evidence of legislative approval of the regulation."

To the same effect are *Burnet* v. *Thompson Oil & G. Co.*, 283 U. S. 301, and *Helvering* v. *Bliss*, 293 U. S. 144.

## Conclusion

It therefore appears that the distinction made by Art. 1504 of Reg. 65 between a trust and an association, based upon the doing of business, is a distinction in accordance with the decisions of the courts as heretofore pointed out, and has been approved by Congress in its successive re-enactments of the provisions of the Revenue Act of 1924. Until such time as Congress shall change the statute so as specifically to provide for the taxation as corporations of common law trusts which are not engaged in doing business for profit, it is submitted that the test of doing business for profit as one of the necessary indicia of an association must continue to prevail.

Respectfully,

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JOHN ROSS DELAFIELD,
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# APPENDIX

Regulations 86, promulgated under the Revenue Act of 1934:

REG. 86, ART. 801-2. Association.—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

REG. 86, ART. 801-3. Association distinguished from trust.—The term "trust" as used in the Act, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners nor creators of the

trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Act as a corporation.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advan-

tages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Act disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.